Supreme Court U.S.
FILED
JAN 2 2003
OFFICE OF THE CLERK

No. 02-829

In the

Supreme Court of the United States

DISCOVER BANK,

Petitioner,

v.

JOHN SZETELA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
CALIFORNIA COURT OF APPEAL, FOURTH APPELLATE DISTRICT

RESPONDENTS' BRIEF IN OPPOSITION

Brian R. Strange
Counsel of Record
Strange & Carpenter
12100 Wilshire Boulevard
Suite 1900
Los Angeles, CA 90025
(310) 207-5055
Attorneys for Respondent

CURRY & TAYLOR ♦ (202) 393-4141 ♦ HTTP://USSCINFO.COM

QUESTION PRESENTED

Whether the California Court of Appeal properly applied state law relating to unconscionability of contracts in ruling that the "no class action" provision in Discover Bank's ("Discover") arbitration clause is unconscionable and unenforceable under the specific facts and circumstances of this case.

PARTIES TO THE PROCEEDINGS

Petitioner, defendant-respondent in the court below, is Discover Bank.

Respondent is John Szetela, plaintiff-appellant in the court below.

James Shea and Barbara Hernandez are also named plaintiffs in the trial court proceedings below, although they were not appellants in the California Court of Appeal case, and they are not respondents herein. In addition, Barbara Hernandez has been appointed as a representative of a certified class of plaintiffs, consisting of former and current Discover cardholders.

TABLE OF CONTENTS

Question Presented i

Parties to the Proceedings ii

Table of Contents iii

Table of Authorities iv

Opinions Below 1

Jurisdiction 1

Constitutional and Statutory Provisions Involved 1

Introduction and Summary of Argument 2

Brief in Opposition Statement 2

Reasons for Denying the Petition 7

Conclusion 16

TABLE OF AUTHORITIES

CASES

ACORN v. Household International, Inc.,
211 F. Supp. 2d 1160 (N.D. Cal. 2002)..... 11, 12, 14

Blue Cross of California v. Superior Court,
67 Cal. App. 4th 42 (1998)..... 10

Comb v. Paypal, Inc.,
218 F. Supp. 2d 1165 (N.D. Cal. 2002)..... 12, 13, 14

Doctor's Associates, Inc. v. Casarotto,
517 U.S. 681 (1996)..... 8, 10

Ferguson v. Countrywide Credit Industries, Inc.,
298 F.3d 778 (9th Cir. 2002)..... 14

Luna v. Household Finance Corporation,
---F. Supp. 2d ---, 2002 WL 31487425
(W.D. Wash. 2002)..... 14

Szetela v. Discover Bank,
97 Cal. App. 1094 (2002)..... 2

Ting v. AT&T,
182 F. Supp. 2d 902 (N.D. Cal. 2002)..... 14, 15

STATUTES

Federal Arbitration Act [9 U.S.C. section 2]

CONSTITUTIONAL PROVISIONS

Supremacy Clause of the United States
Constitution [U.S. Const., art. VI, cl. 2]..... 1, 10

RULES OF THE UNITED STATES SUPREME COURT

Rules of the United States Supreme Court, Rule 10 7

Rules of the United States Supreme Court, Rule 10(c)..... 8

OPINION BELOW

The opinion of the California Court of Appeal is reported at 97 Cal. App. 4th 1094, 118 Cal. Rptr. 2d 862 (Cal. Ct. App. 2002), and is reprinted in the Petitioner's Appendix ("Pet. App.") at 1a. The order of the California Supreme Court denying Discover's petition for review is not reported; it is reprinted at Pet. App. 12a.

JURISDICTION

The California Court of Appeal issued its decision on April 22, 2002. Pet. App. 1a. The California Court of Appeal denied Discover's petition for rehearing on May 16, 2002. Pet. App. 10a. The California Supreme Court denied Discover's petition for review on July 31, 2002. Pet. App. 11a. On October 21, 2002, Justice O'Connor entered an order extending Discover's time to file this Petition for a Writ of Certiorari until November 28, 2002. Discover contends that this Court has jurisdiction under 28 U.S.C. section 1257, but plaintiff/respondent John Szetela ("Szetela") disputes that this Court has jurisdiction over this matter.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Discover contends that this case involves questions arising under the Supremacy Clause of the United States Constitution [U.S. Const., art. VI, cl. 2.] and section 2 of the Federal Arbitration Act [9 U.S.C. section 2]. Szetela disputes that this case implicates either of these provisions. Rather, this case involves only state common law of unconscionability of contracts.

INTRODUCTION AND SUMMARY OF ARGUMENT

In order to pique this Court's interest, petitioner Discover attempts to characterize the question on this Petition for a Writ of Certiorari as whether the California Court of Appeal decision in Szetela v. Discover Bank, 97 Cal. App. 1094 (2002) (hereinafter, "Szetela") "conflicts" with federal law, including the Federal Arbitration Act ("FAA") and federal case law. However, the Szetela decision has nothing to do with federal law. While Szetela does involve an arbitration agreement subject to the FAA, the question in Szetela involved state unconscionability law. The law is clear, and this Court has expressly stated, that state law contract defenses, including unconscionability, are applicable to arbitration clauses governed by the FAA, to the same extent that they are applicable to other contracts. There is nothing in the FAA or federal law which prevents a state court from applying state unconscionability law to find a portion of an arbitration agreement subject to the FAA unconscionable. This is all that the California Court of Appeal in Szetela did. Therefore, no "conflict" with federal law is created as a result of the California Court of Appeal's finding that, under the specific facts and circumstances of this case, Discover's arbitration agreement is unconscionable insofar as it purports to preclude classwide relief. There is simply no question of federal law, let alone a compelling question of federal law or a "conflict" with federal law, justifying review by this Court. Discover's Petition for a Writ of Certiorari should be denied.

BRIEF IN OPPOSITION STATEMENT

1. On October 19, 2000, plaintiff James Shea, a New Jersey resident, brought this action on behalf of himself and a class of persons who have been improperly charged overlimit fees by Discover. On December 15, 2000, plaintiff filed a

first amended complaint, adding John Szetela, a California resident, as an additional representative plaintiff. 1

2. The relevant facts relating to John Szetela's Discover credit card agreement are as follows: John Szetela opened his credit card account with Discover in July 1993, at which time Discover sent Mr. Szetela a Cardmember Agreement governing his account. In September 1999, Discover purported to "amend" the agreement to add an arbitration clause. The newly added arbitration section provides as follows:

> "ARBITRATION. WE ARE ADDING A NEW SECTION TO READ AS FOLLOWS:

ARBITRATION OF DISPUTES. In the event of any past, present or future claim or dispute (whether based upon contract, tort, statute, common law or equity) between you and us arising from or relating to your Account, any prior account you have had with us, your application, the relationships which result from your Account or the enforceability or scope of this arbitration provision, of the Agreement or of any prior agreement, you or we may elect to resolve the claim or dispute by binding arbitration.

IF EITHER YOU OR WE ELECT ARBITRATION, NEITHER YOU NOR WE SHALL HAVE THE RIGHT TO LITIGATE THAT CLAIM IN COURT OR TO HAVE A JURY TRIAL ON THAT CLAIM. PRE- HEARING DISCOVERY RIGHTS AND POST- HEARING APPEAL RIGHTS WILL BE LIMITED. NEITHER YOU NOR WE

---

[1] While the merits of this case are not at issue on this Petition for a Writ of Certiorari, it is important to note that, while the class damages are substantial in the aggregate, each class member's individual damages are very small.

SHALL BE ENTITLED TO JOIN OR CONSOLIDATE CLAIMS IN ARBITRATION BY OR AGAINST OTHER CARDMEMBERS WITH RESPECT TO OTHER ACCOUNTS, OR ARBITRATE ANY CLAIMS AS A REPRESENTATIVE OR MEMBER OF A CLASS OR IN A PRIVATE ATTORNEY GENERAL CAPACITY."

(underline emphasis added).

3. Based on this arbitration clause, on January 16, 2001, Discover filed a Motion to Compel Arbitration of Plaintiff John Szetela's Individual Causes of Action and to Stay Further Proceedings. The trial court reluctantly granted Discover's motion.

4. John Szetela individually arbitrated his claims against Discover and was awarded the entire amount of his individual claim, $29.00, plus costs.

5. John Szetela also timely appealed the trial court's ruling compelling him to individually arbitrate. The California Court of Appeal treated the appeal as a writ petition, and ruled in a published opinion on April 22, 2002, that, under the specific facts and circumstances of this case, the "no class action" clause in Discover's arbitration agreement is unenforceable under the state law contract defense of unconscionability. The California Court of Appeal therefore struck the "no class action" clause in Discover's arbitration agreement.

The court did not strike the arbitration agreement in its entirety. However, because the real purpose of Discover's arbitration agreement is to preclude class actions, and not really to require arbitration of disputes, Discover chose not to arbitrate on a classwide basis.

6. In the Szetela decision, the California Court of Appeal analyzed all of the facts relevant to the unconscionability analysis and made numerous findings, including the following:

i. The weaker party (Mr. Szetela) was presented the "no class action" clause and told to "take it or leave it" without the opportunity for meaningful negotiation. Pet. App. 7a.

ii. The "no class action" clause was imposed in an oppressive manner. Pet. App. 7a.

iii. The "no class action" clause is unfair. Pet. App. 7a-8a.

iv. The "no class action" provision is "'so one-sided as to 'shock the conscience.'" Pet. App. 7a.

v. The issue of whether Discover's "no class action" provision is unconscionable is not even a close call. Rather, "[t]he manifest one-sidedness of the no class action provision . . . is blindingly obvious." Pet. App. 7a.

vi. Discover's "no class action" clause "is clearly meant to prevent customers, such as Szetela and those he seeks to represent, from seeking redress for relatively small amounts of money, such as the $29 sought by Szetela." (emphasis added). Pet. App. 7a-8a.

vii. Discover is "[f]ully aware that few customers will go to the time and trouble of suing in small claims court, [so] has instead sought to create for itself virtual immunity from class or representative actions despite their potential merit, while suffering no similar detriment to its own rights." Pet. App. 8a.

viii. Discover's "no class action" provision is "harsh and unfair to Discover customers who might be owed a relatively small sum of money." Pet. App. 8a.

ix. Discover's "no class action" provision "serves as a disincentive for Discover to avoid the type of conduct that might lead to class action litigation in the first place." Pet. App. 8a.

x. "By imposing this clause on its customers, Discover has essentially granted itself a license to push the boundaries of good business practices to their furthest limits, fully aware that relatively few, if any, customers will seek legal remedies, and that any remedies obtained will only pertain to that single customer without collateral estoppel effect." Pet. App. 8a.

xi. Discover's "no class action" provision creates "[t]he potential for millions of customers to be overcharged small amounts without an effective method of redress." Pet. App. 8a.

xii. Discover's "no class action" clause "violates fundamental notions of fairness." Pet. App. 8a.

7. Discover filed a petition for rehearing of the Szetela decision in the California Court of Appeal. The California Court of Appeal denied Discover's petition for rehearing on May 16, 2002.

8. Discover filed a petition for review in the California Supreme Court. The California Supreme Court denied Discover's petition for review on July 31, 2002.

REASONS FOR DENYING THIS PETITION

I. The Szetela Opinion Does Not Raise Any Federal Questions, Let Alone Compelling Federal Questions, Justifying Review on Certiorari

Because the Szetela opinion does not raise any federal questions, let alone compelling federal questions, this Court should not grant review on certiorari. Rule 10 of the Rules of the United States Supreme Court provides in part as follows:

> "Review on a writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only for compelling reasons. The following, although neither controlling nor fully measuring the Court's discretion, indicate the character of the reasons the Court considers: . . .
>
> > (b) a state court of last resort has decided an important federal question in a way that conflicts with the decision of another state court of last resort or of a United States court of appeals;
> >
> > (c) a state court . . . has decided an important federal question in a way that conflicts with relevant decisions of this Court.
>
> A petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings or the

misapplication of a properly stated rule of law."

(emphasis added)

The California Court of Appeal in the Szetela case simply did not decide a federal question, let alone an "important" federal question, justifying review on certiorari. The Szetela decision does not apply, and does not even purport to apply, federal law (other than citing to this Court's decision in Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681 (1996), which holds that state contract defenses apply to arbitration agreements governed by the FAA). Federal law is simply irrelevant to the Szetela Court's analysis under state unconscionability law. Therefore, there is no federal question implicated by the Szetela decision, and this Court should not review a state court opinion which does nothing more than apply state law.

II. The Szetela Opinion Does Not "Conflict" With The Opinions Of This Court (Or Any Other Federal Law)

Even if the Szetela Court had decided an important issue of federal law (which it did not), this Court should not grant review on certiorari because the Szetela decision does not "conflict" with any decisions of this Court. See Rule 10(c) of the Rules of the United States Supreme Court. [2]

---

[2] In its Petition for a Writ of Certiorari, Discover cites to both Rules 10(b) (relating to conflicts with federal courts of appeals) and 10(c) (relating to conflicts with decisions of this Court) of the Rules of the United States Supreme Court. See Petition, page 3. However, Rule 10(b) does not even potentially apply. Rule 10(b) applies only when "a state court of last resort has decided an important federal question in a way that conflicts with the decision of another state court of last resort or of a United States court of appeals." (emphasis added). The California Supreme Court denied review of the Szetela decision, and there has therefore been no decision by "a state court of last resort." Therefore,

The key factor is that the California Court of Appeal has not compelled classwide arbitration in this case, as repeatedly suggested by Discover throughout its brief. Nor has the California Court of Appeal certified classwide arbitration in this matter.

Discover attempts to label and characterize California as representing a minority view which provides for the imposition of class action procedures on arbitration agreements that are either silent as to such procedures or that expressly preclude them. Nowhere is such a view expressed.[3] Indeed, California follows the universally accepted view, expressed by this Court, that an arbitration agreement is subject to state law defenses, including unconscionability.[4] Federal law, as set forth in the decisions of this Court and elsewhere, simply does not require that unconscionable arbitration agreements, or unconscionable portions thereof, be enforced. On the contrary, federal law specifically provides that arbitration agreements are subject to ordinary state law contract defenses, including unconscionability. Therefore,

---

there is no basis for review under the standards set forth in Rule 10 of the Rules of this Court absent a conflict with a decision of this Court. Moreover, as set forth below, there is no conflict with any decisions of any federal courts of appeals in any event.

[3] Discover refers to the California rule -- that classwide arbitration may be imposed when the parties agree to arbitrate, even if the parties expressly preclude classwide arbitration in their contract. This is simply not the holding of the Szetela Court.

[4] Discover suggests that parties to standard contracts containing standard arbitration provisions face the prospect of starkly different proceedings arising from those contracts -- all depending on whether they sue or are sued in California or somewhere else. The truth, however, is that no state will enforce a contract provision that is unconscionable. Thus, Petitioner's real argument lies in its assertion that another state's courts might not reach the same conclusion as the California court regarding the unconscionability and one-sidedness of the provision in question under the facts and circumstances of this case. This argument is not only without merit, but it is simply not a federal question at all.

the California Court of Appeal's application of state unconscionability law in the Szetela decision is in no way inconsistent with (and, in fact, is specifically authorized by) the FAA and other federal law, including decisions of this Court.

The central purpose of the FAA is not "enforcing arbitration agreements according to their terms" when the terms are unconscionable. Rather, the FAA provides that an arbitration agreement subject to the Act is "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (emphasis added). Therefore, an arbitration agreement is invalid if there is a contract defense, such as unconscionability. As this Court made clear in Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681, 687 (1996), "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements." (emphasis added). In fact, the California Court of Appeal in Szetela properly cited to this Court's opinion in Doctor's Associates for the proposition that "[a]n agreement to arbitrate is enforceable unless a recognized contract defense, such as unconscionability, exists." See Pet. App. 5a. Other California case law is also clear that state law is not preempted by the FAA on matters not specifically covered in the FAA itself (including specifically the issue of classwide arbitration). See, e.g., Blue Cross of California v. Superior Court, 67 Cal. App. 4th 42, 47 (1998) (the court agreed with plaintiffs' argument "that California's procedural law concerning the conduct of arbitration was not preempted by the [Federal Arbitration A]ct.").

Some recent federal district court decisions with similar holdings to the Szetela decision also make clear that state contract defenses, including unconscionability, apply to arbitration agreements, just as they apply to all other

contracts. For example, the recent decision in ACORN v. Household International, Inc., 211 F. Supp. 2d 1160 (N.D. Cal. 2002) (which ruled that an arbitration agreement was unconscionable, based in part on a "no class action" clause similar to the clause at issue in this case) is instructive. In that case, the court stated:

> "In determining whether an agreement to arbitrate is valid, federal courts must 'apply ordinary state-law principles that govern the formation of contracts.' . . . 'General contract defenses such as fraud, duress or unconscionability, grounded in state contract law, may operate to invalidate arbitration agreements . . .'"

Id. at 1167. The court in ACORN further rejected an argument very similar to Discover's argument here:

> ". . . Defendants argue that because classwide arbitration is disfavored in federal court, it could not be unconscionable to prohibit class-wide arbitration in an arbitration agreement whose substantive terms are governed by the FAA.
>
> This subtle argument is ultimately unpersuasive. Defendants have merged the substantive unconscionability analysis with the analysis of the appropriate remedy upon a finding of unconscionability. These questions, however, are analytically distinct. The first question is whether the contract at issue is unconscionable. This is a question of State law. . . . Upon concluding that a contract is unenforceable under State law, the court must

> then turn to potential remedies. Because California courts may order class-wide arbitration, the appropriate remedy in State court may be to strike the unconscionable provision and enforce the remainder of the agreement. In doing so, a State court is able to enforce the agreement of the parties to the extent that agreement is not unconscionable."

Id. at 1171. Here, the question addressed by the Szetela Court was whether the "no class action" provision was unconscionable under state law. Upon concluding that the "no class action" provision was unconscionable, the Szetela Court then turned to the potential remedies, and struck the "no class action" provision from the arbitration agreement. In doing so, the California Court of Appeal was able to enforce the arbitration agreement, governed by the FAA, to the extent that it is not unconscionable under state law, which is no less than federal law requires. This was perfectly appropriate under applicable California law and entirely consistent with federal law.

The recent federal district court decision in Comb v. Paypal, Inc., 218 F. Supp. 2d 1165 (N.D. Cal. 2002) is also instructive. In that case, the court relied on state law to invalidate an arbitration agreement governed by the FAA on the ground that it was unconscionable. One of the factors the court considered was the prohibition on consolidation of claims. The court stated:

> "'The FAA creates a body of federal substantive law of arbitrability, enforceable in both state and federal courts and pre-empting any state laws or policies to the contrary.' . . . As a result, state laws hostile to arbitration agreements have been held invalid on the

> ground that such laws frustrate congressional intent to place arbitration agreements on the same footing as other contracts. . . .
>
> State law is not entirely displaced from FAA analysis, however. It is undisputed that 'generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2.'"

Id. at 1170. The Court in Comb went on to cite to the Szetela decision and discuss (and reject) one of the arguments Discover makes in this Petition for a Writ of Certiorari:

> "PayPal argues that because federal cases applying the FAA have enforced arbitration clauses containing such prohibitions on collective actions, Szetela is irrelevant to the present proceedings. In the Ninth Circuit, however, while the FAA preempts any legislation 'specifically aimed at arbitration agreements,' '[i]n all situations where arbitration provisions are placed on the same footing as other contracts, state law applies.' Ticknor, 265 F.3d at 941 (citation and internal quotation omitted). Thus, while California's consumer protection statutes cannot prevent enforcement under the FAA of a prohibition on collective actions as such, a federal court properly may consider whether such a prohibition in combination with other provisions and circumstances renders an agreement substantively unconscionable as a matter of state law."

Id. at 1175-76 (footnote omitted). Similarly here, state contract defenses, including unconscionability, apply and are not preempted by the FAA or other federal law.

It is also significant that, far from being in "conflict" with federal law, the Szetela decision has actually been cited with approval by several federal courts, including the courts in both ACORN and Comb. See ACORN, supra, 211 F. Supp. 2d 1160 (citing to Szetela, the court denied a motion to compel arbitration, holding, among other things, that "the prohibition on class actions, although facially neutral, in reality benefits Defendants and restricts Plaintiffs' ability to secure any remedy at all."); and Comb, supra, 218 F. Supp. 2d 1165 (citing Szetela and holding that an arbitration agreement, which, among other things, prevented consolidation of claims, was unconscionable and unenforceable). In addition to these Northern District of California cases, the Szetela opinion has been cited with approval by two other federal courts, including once by the United States District Court for the Western District of Washington and once by the Ninth Circuit Court of Appeals.[5] See Luna v. Household Finance Corporation, --- F. Supp. 2d ---, 2002 WL 31487425 (W.D. Wash. 2002) (citing to Szetela, ACORN, supra, 211 F. Supp. 2d 1160, and Ting v. AT&T, 182 F. Supp. 2d 902 (N.D. Cal. 2002), among other cases, the court stated that the unfairness of the "no class action" provision "weighs heavily in favor of a finding of substantive unconscionability."); and Ferguson v. Countrywide Credit Industries, Inc., 298 F.3d 778 (9th Cir. 2002) (The court cited to Szetela, and upheld the denial of a petition to compel arbitration on the grounds that the arbitration clause was both procedurally and substantively unconscionable."). Therefore, the Szetela case is not "inconsistent" with federal law, and

---

[5] Notably, in its Petition for a Writ of Certiorari, Discover does not even mention the Ninth Circuit opinion citing the Szetela case.

has even been cited with approval by the Ninth Circuit Court of Appeals.

In addition to the cases citing it, the Szetela case is also consistent with other recent decisions, including other federal court decisions which come to similar holdings. See, e.g., Ting, supra, 182 F. Supp. 2d 902 (The court held, among other things, that a provision in an arbitration clause purporting to preclude classwide relief was procedurally and substantively unconscionable and unenforceable under state law.)[6]

---

[6] As set forth above, Rule 10(b) of the Rules of the United States Supreme Court, which refers to "conflicts" with the decisions of the United States Courts of Appeals, does not apply here. Nevertheless, it does bear brief mention that there is no "conflict" with any United States Courts of Appeals' decisions. The Seventh Circuit has held that courts are without authority to order class-wide arbitration unless the parties have expressly agreed to that procedure. This does not conflict with the Szetela decision since the Szetela Court did not order class-wide arbitration. It simply held the ban on classwide relief unconscionable under the facts and circumstances of this action. The Third, Fourth, Eighth, and Eleventh Circuits have enforced arbitration agreements despite the unavailability of class action procedures under those agreements. However, in none of those cases was there a finding of unconscionability in the arbitration agreement itself. There is no conflict between the decisions of these cases and the decision of the Szetela Court. The fact is that some arbitration agreements may be enforceable while others may not be. It depends on the facts and circumstances of the case and the agreement in question. Whether a specific agreement is unconscionable under the facts and circumstances of the case is a question of state law. There is no federal law which requires that all arbitration agreements be enforced according to their terms, regardless of the nature and wording of the arbitration agreement or the facts and circumstances under which it is invoked. The Second, Fifth, Sixth, Eighth, Ninth, and Eleventh Circuit decisions which preclude courts from requiring consolidation of arbitration proceedings unless the parties expressly provide for such procedures in their arbitration agreements do not conflict with the Szetela decision for two reasons. First, there was no finding of unconscionability in any of the cases cited by petitioner. Second, the Szetela Court did not order consolidation of arbitration proceedings.

Therefore, while respondent does not dispute that the FAA governs the arbitration clause in this case, the FAA and cases falling thereunder do not require that an unconscionable arbitration provision, including an unconscionable "no class action" clause, be given effect. The Szetela decision presents no "conflict" with federal law, and this Court should not grant review on certiorari.

CONCLUSION

For the foregoing reasons, this Court should deny Discover's Petition for a Writ of Certiorari.

Respectfully submitted,

Brian R. Strange
Strange & Carpenter
12100 Wilshire Boulevard,
Suite 1900
Los Angeles, California 90025
(310) 207-5055

Counsel for Respondent.